S23a6/collateral
not released or converted

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Savannah Division

In the matter of: JOHNNY RAY GRINER d/b/a Griner Timber Company d/b/a Griner Logging Company (Chapter 11 Case 89-41549) Debtor ORIX CREDIT ALLIANCE, INC. f/k/a First Interstate Credit Alliance Plaintiff v. JOHNNY RAY GRINER d/b/a Griner Timber Company d/b/a Griner Logging Company Defendant	Adversary Proceeding Number 90-4147

FILED
at 12 O'clock & 30 min. P M
Date 12/20/90
MARY C. BLOCTON, CLERK
United States Bankruptcy Court
Savannah, Georgia pcb

MEMORANDUM AND ORDER

The above-captioned adversary proceeding was tried on October 31, 1990. After consideration of the evidence and all applicable authorities I make the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

This Complaint to Determine Dischargeability arises out of allegations that the Debtor pledged a number of items of collateral to secure an indebtedness owed to the Plaintiff, that some of the items have been sold by the Debtor without remitting the proceeds of sale to the Plaintiff and that the Debtor's actions thereby constitute willful and malicious injury within the meaning of 11 U.S.C. Section 523(a)(6).

For ease of reference in this Order the items of collateral in issue will be identified as follows:

Collateral A: HydroAX Feller Buncher Model 511B, Serial No. 2104

Collateral B: Timberjack Log Skidder, Model 240, Serial No. 840365

Collateral C: Prentice Log Loader on 1973 Chevrolet Chassis, Model 210(C60), Serial No. 210Z13066

Collateral D: Timberjack Log Skidder, Model 240, Serial No. AC7659

On June 29, 1987, Debtor entered into a lease agreement with the Plaintiff's predecessor to lease Collateral A from the Plaintiff for a forty-two month term. On the same date he executed a security agreement apparently granting to the Plaintiff's predecessor a security interest in Collateral A, Collateral B and Collateral C (Exhibits P-1 and P-2). On April 5, 1989, Debtor entered into a thirty-eight month lease agreement with the Plaintiff's predecessor to lease Collateral D and executed a security agreement on the same date conveying to the Plaintiff's predecessor a security interest in Collateral A and D only. (Exhibits P-3 and P-4). Collateral B and C were omitted from the 1989 security agreement. However, the 1987 security agreement provided that it secured payment to the Plaintiff's predecessor of "any and all mortgage obligations (as hereinafter defined) of mortgagor [debtor] to mortgagee [plaintiff]" (Exhibit P-2, paragraph 1). Mortgage obligations were defined in paragraph two as "all loans, advances, payments, extensions of credit, endorsement, guarantees, benefits, and financial accommodations heretofore or hereafter made granted or extended by mortgagee . . . to or for the account of mortgagor . . . <u>including</u> . . . <u>equipment lease agreements</u> . . . " (emphasis added).

During the course of the proceedings in Debtor's underlying Chapter 11 case, it has been revealed and indeed Debtor

does not dispute in this proceeding that he is not in possession of Collateral B or C. He testified that when he signed Schedule A to the Plaintiff's Exhibit 2, the 1987 security agreement, the collateral description was not filled in. He further testified that he never owned Collateral B or C but had previously owned similar equipment (a Model 230 Timberjack Skidder and a Model 150 Prentice Log Loader), which he had sold with the assistance of Pioneer Machinery, an equipment dealer, to W. M. Shepherd Lumber Company. Debtor testified that he used the proceeds of that sale to make the advance rent payment due on Collateral A. (See Exhibit P-31 and P-1).

Plaintiff's representative testified that Schedule A to Exhibit P-2 was prepared, fully completed, in Atlanta prior to being sent to the Debtor for his signature. However, he admitted that he was not present when the documents were prepared or signed but was testifying only that it was the company's normal procedure to handle documents in that manner. Plaintiff produced bills of sale tending to show that the Debtor owned Collateral B (see Exhibit P-9) and Collateral C (see Exhibit P-8). However, neither of those documents were signed by the Debtor. Exhibit P-9 is an invoice showing a sale by Pioneer Machinery, Inc., to Griner Timber and bearing the signature of Adolphus Johnson as seller, on February 26, 1987, but it was not signed or accepted by the Debtor. Likewise, Exhibit P-

8 appears to be an invoice showing a sale to Griner on February 25, 1986, by Claxton Trucking, but again there is no signature of the Debtor on it and the representation that Collateral C was sold to Griner on that date by Claxton Trucking was made by Billy Roundtree of Pioneer Equipment in a handwritten note at the bottom of the Exhibit.

Billy Roundtree serves as Division Manager of Pioneer and initially testified that Schedule A to Exhibit P-2 was complete at the time Griner signed them. Roundtree testified that he had handled the sale by Griner to W. M. Shepherd Lumber of the Prentice Model 150 and Timberjack Model 230 in March, 1987. Roundtree further testified that although only Collateral A was being financed in the June, 1987, transaction, he was aware that the Plaintiff as a condition of the loan, required that additional collateral be pledged by Griner. He testified, however, that two sets of documents were forwarded by the Plaintiff to him for Debtor's signature. The first set of documents only required that Collateral A be pledged. The second set of documents, according to him, required the additional pledge of Collateral B and C. Mr. Roundtree's company did not sell Mr. Griner Collateral B or C and he was unaware how the serial numbers from those two items of collateral were obtained. Mr. Roundtree was unfamiliar with why Collateral B and C were omitted from the 1989 security agreement

(Plaintiff's Exhibit 4, Schedule A) and admitted that the Debtor had been in possession of Collateral A for several weeks prior to the time any documents were signed. Upon cross examination Mr. Roundtree corrected his earlier statement that Exhibit A to P-2 was filled in when signed by Griner. He testified "To be exact on the second or the first set of documents, I know the documents were filled out." Construing the entirety of his testimony, it is only clear that one completed set of documents was sent to his company for Griner's signature. He was not able to establish whether Schedule A to Exhibit P-2 (the second set of documents) contained the description of Collateral A, B and C when Griner signed it or whether it was blank, as testified to by Griner.

Larry Cross, a sales representative of the Plaintiff, testified that he verified the serial numbers on Collateral B and C after delivering Exhibits P-1 and P-2 to Pioneer for Pioneer to obtain the Debtor's signature. He testified that the Exhibits were not blank when he delivered them to Pioneer but that he did not see the Debtor sign them. Apparently only Mr. Roundtree was present at that time. After the executed documents were received he inspected Collateral B which was located in the yard at Pioneer Machinery and Collateral C which was located by itself in the woods. He verified the serial numbers on each of them and took photographs as evidenced by Exhibits P-6 and P-7. However, at no time did he see Mr. Griner

at the time of his inspection of either of these items nor did Mr. Griner ever represent to Cross that Griner owned them. This information came solely from Pioneer Machinery.

The 1987 credit application was prepared by Mr. Cross from discussions with Pioneer and Griner and approved by the Plaintiff, but Mr. Griner did not sign it. The credit inquiry approved by the Plaintiff on June 18, 1987, (Exhibit P-26) shows that the application was originally forwarded on or about May 22, 1987. An initial analysis of the file on May 26th by employees of the Plaintiff indicated concern over making the loan because it would double the Debtor's debt and because logging was not his primary job. On June 11, 1987, the recommendation was made that "we pass" due to weak cash flow and part-time commitment of management. However, at a later time the Plaintiff reversed itself and made the decision to advance funds but reduced the credit to approximately $97,000.00 instead of the $120,000.00 requested. This allowed Griner to finance only one piece of equipment. Credit approval was also contingent upon the pledge of collateral in addition to that financed. However, there was no evidence that the information on P-26 concerning additional collateral was communicated to anyone other than Pioneer Machinery and specifically it is uncontradicted that it was not communicated to Griner. Plaintiff's decision to make the loan was made on June 18, 1987, as evidenced by the

document. By Griner's testimony on June 18th, he had already been in the possession of Collateral A for a period of over two months after Pioneer delivered it to him and he had been engaged in logging operations with it since that time.

Cross admitted that there had been a second set of documents presented to Griner for signature because of the reduction in the amount of money that was being advanced and the requirement of additional collateral. He conceded that there could have been a set of documents pledging only Collateral A among the two sets of documents. Finally, he testified that he did not see Griner sign the financing documents, P-1 or P-2, and was unable to explain why Collateral B and C were not included on the 1989 documents. He admitted that even though the open-end clause on P-2 would serve to preserve the Plaintiff's security interest in that collateral, it would have been their normal practice to specifically include Collateral B and C in any subsequently executed documents.

Griner testified that he was never informed by anyone that additional collateral other than Collateral A would be required. The lease agreement executed in 1987 (P-1) is being serviced on a current basis by payments made by the Debtor. Debtor remains in possession of collateral A. The current balance on that account as of October 31, 1990, was $41,042.04. The 1989 lease

agreement pledging Collateral A and D was defaulted on and by previous Order of this Court entered March 13, 1990, relief from the automatic stay was granted to the Plaintiff to foreclose its interest in Collateral D and to dispose of it. The collateral was disposed of by the Plaintiff and a substantial deficiency balance of $35,904.51 as of the date of sale remains. Debtor has filed an objection to the deficiency claim which objection will be dealt with by separate order.

The Plaintiff's complaint asserts the outstanding deficiency indebtedness owed by the Debtor to the Plaintiff should be declared non-dischargeable inasmuch as Debtor violated the provisions of 11 U.S.C. Section 523(a)(6) in disposing of collateral which was pledged to the Plaintiff, without permission and without accounting for the proceeds of sale. Debtor contends that he never owned Collateral B and C, did not sign any document on which they were listed and that they were added later by mistake or design by Pioneer or Plaintiff.

CONCLUSIONS OF LAW

Plaintiff seeks to have the debt owing to it excepted from discharge pursuant to 11 U.S.C. Section 523(a)(6) which

provides in relevant part that:

> A discharge . . . does not discharge an individual debtor from any debt--
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

The Eleventh Circuit in Chrysler Credit Corp. v. Rebhan, 842 F.2d 1257 (11th Cir. 1988) approved and adopted the approach set forth in United Bank of Southgate v. Nelson, 35 B.R. 766 (M.D. Ill. 1983) in construing the "willful and malicious" element of 11 U.S.C. Section 523(a)(6). Under Southgate "willful means deliberate or intentional" and "malice for purposes of section 523(a)(6) can be established by a finding of implied or constructive malice". Rebhan at 1263. "Thus, the conversion must not be accidental or the result of negligence. Moreover, while 'malice' does not require an 'intent to harm', the debtor must know that the conversion is inconsistent with the rights of another." In re Alfred Dowdy, CV588-033, 6 (S.D. Ga. July 20, 1988) (emphasis original). Finally, "[t]here is no question but that the party seeking to except a debt from discharge must prove the willfulness and maliciousness of the act by clear and convincing evidence." Rebhan at 1262, citing Matter of Wise, 6 B.R. 867 (Bankr. N.D.Fla. 1980).

"Injuries within the meaning of the exception are not confined to physical damage or destruction; but an injury to intangible personal or property rights is sufficient." 3 Collier on Bankruptcy, ¶523.16 at 523-118 (15th Ed. 1989).

"[A] willful and malicious injury does not follow as of course from every act of conversion, without reference to the circumstances. There may be a conversion which is innocent or technical, an unauthorized assumption of dominion without willfulness or malice. There may be an honest but mistaken belief, engendered by a course of dealing, that powers have been enlarged or incapacities removed. In these and like cases, what is done is a tort, but not a willful and malicious one." Davis v. Aetna Acceptance Co., 293 U.S. 328, 331, 55 S.Ct. 151, 153 (1934) (citations omitted).

As applied to the facts in this case I conclude that Debtor is entitled to prevail. This Court has ruled in many prior cases that Section 523(a)(6) encompasses an unauthorized sale of pledged collateral when a debtor converts the proceeds to his own use. However, it is fundamental that exceptions to discharge are strictly construed and must be proven by clear and convincing evidence. Schweig v. Hunter (In re Hunter), 780 F.2d 1577, 1579 (11th Cir. 1986).

Plaintiff's case fails to carry this difficult burden. The transaction is replete with confusion. Debtor vehemently denies ever owning or ever pledging Collateral B or C. No witness has testified that Schedule A to Exhibit P-2 was completed and contained the description of Collateral B and C when Griner signed it. There is no evidence of a sale by Griner of Collateral B or C to anyone or evidence that he received and converted proceeds from such a sale. Thus, Debtor's testimony on this point stands uncontradicted. It is clear that Pioneer had delivered collateral A to Griner approximately two months prior to the credit approval and subsequent credit approval by Plaintiff was conditioned upon changes in the original loan application which were never communicated to Griner. Griner never represented in writing or verbally that he owned Collateral B or C, and when Plaintiff extended additional credit in 1989, it did not list Collateral B or C on its loan documents even though it would be its normal practice to list all previously pledged collateral on any new transaction. In this state of the record I cannot conclude that Debtor ever represented ownership of collateral he did not own or that he sold pledged collateral and converted the proceeds. The only witness to his signature can only testify that one of two sets of documents were complete when signed by Griner. Apparently through mistake or design on the part of someone other than Griner, Collateral B and C were listed as

collateral on Exhibit P-2 after he signed the second version of Schedule A presented to him for signature. It is impossible from the record to determine who may have completed the document. However, for the decision before me it is only necessary to determine that Griner never pledged the collateral in question for Griner to prevail. Since I do reach that conclusion, the fact that collateral is now "missing" does not constitute evidence of a conversion.

O R D E R

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that this adversary proceeding is dismissed.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia
This 20th day of December, 1990.